



* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Date of decision: 31st October, 2013

+ **ITA 1189/2011**

CIT LARGE TAX PAYERS UNIT Appellant
Through Mr. N.P. Sahni, Sr. Standing
Counsel.

versus

INDIAN RAILWAY FINANCE CORP LTD Respondent
Through Mr. S. Kirshnan, Advocate.

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE SANJEEV SACHDEVA

SANJIV KHANNA, J. (ORAL)

This appeal by the revenue pertains to assessment year 2001-02.

Revenue has raised four questions in this appeal and for the sake of convenience these issues are being discussed separately:-

Issue No.1

Whether the lease equalisation charges can be disallowed/deleted from the profit and loss account for the purposes of computing book profits under Section 115 JB of the Income Tax Act, 1961?

2. The said issue need not be examined in detail as it is covered against the Revenue vide decision in the case of *CIT vs. Virtual Soft Systems Limited*, (2012) 341 ITR 593 (Delhi).



Issue No.2

Whether the lease equalisation charges can be reduced/taken into consideration while calculating profits under the profits and loss account provision of the income Tax Act?

3. This question is also covered by the decision of Delhi High Court in *Virtual Soft Systems Limited* (supra). In the said decision, nature and character of lease equalization charges in case of financial leases was examined and it was observed that lease equalization charges or funds have to be set off or included on the expenditure side in the profit and loss account to compute and calculated the profits. Principle of matching i.e. matching of income with the actual expenditure which is incurred by the assessee to earn the said income applies. In the decision of Delhi High Court in *Virtual Soft Systems Limited* (supra) from paragraph 9 onwards reference was made to Section 145 of the Act and the accountancy standards prescribed by the Institute of Chartered Accountants of India. The accountancy standards prescribed underwent amendment/change from assessment year 1996-97 in respect of financial leases. Nature and character of lease equalization charges/funds was examined in paragraph 11 onwards. In paragraph 7.4 of the said judgment, reference was made to the decision of the tribunal in the present case i.e. the impugned decision and referring to these decisions, findings of the tribunal in the present case was quoted.



4. As we had some doubt whether allowing lease equalization charge as a deduction in the profit and loss account under the normal provisions would lead to double deduction and loss of revenue, we had asked for clarifications as noted in our short order dated 22nd October, 2013.

5. The learned counsel for the parties were informed on 23rd October, 2013 and the appeals were listed today for clarification.

6. To understand and appreciate the contentions, certain undisputed facts and the legal position may be noticed. As noticed in Virtual Soft System Ltd. (supra), 'lease' transactions may take various hues and colours. In the present case, we are concerned only with financial leases and not with an operational lease. In such cases, the lease rent includes the capital as well as purchase price and at the end of the lease tenure the lessee acquires/takes the asset as the owner. The income earned by way of lease rental was the interest (revenue earning) and the amount financed (capital financed) but during the term of the lease, as the respondent continued to be the owner he also enjoyed and claimed benefit of depreciation (an undisputed position as claim of depreciation was not questioned). Depreciation was duly debited and accounted in the profit and loss account.



7. In these circumstances, guidance note issued by the Institute Chartered Accountants in respect of accounting for finance leases applies and the accounts of the respondents meet the requisite parameters and requirements.

8. In Virtual Soft System Ltd.'s case (supra), it is indicated that the Central Government on 25th January, 1996, had issued an accounting standard qua Section 145 of the Act which mandates that accounting policy of assessee should be such as to represent true and fair affairs of the assessee's business. The institute has from time to time published Accounting Standard, in respect of finance leases. Referring to the said position in Virtual Soft Systems Ltd. (supra), it has been observed as under:-

"9. In this background what is required to be considered is whether the books of accounts could be rejected by the assessing officer merely for the reason that recourse to the Guidance Note was taken by the assessee. In this regard, we would be required to examine the provisions of Section 145 of the I.T. Act. Section 145 of the I.T. Act adverts to the method of accounting followed by an assessee. Sub-section (1) of Section 145 provides that income chargeable under the head "profits and gains of business or profession" or "income from other sources" shall be computed either on cash basis or on mercantile system, whichever method being regularly employed by the assessee. This provision is, however, subject to the Central Government notifying A.S. in respect of any class of assessee or class of income. Sub-section (3) of Section 145, empowers the assessing officers to disregard the books of accounts submitted by the assessee only if he is not satisfied with: the correctness or completeness of the accounts of the assessee or, the method of accounting employed by the assessee or on account of A.S. notified under sub-section (2), not being particularly followed by the assessee. In this particular case, the assessing officer has disregarded, in substance, the method of accounting



followed by the assessee qua lease rentals without basing it on the grounds provided in Section 145 of the IT Act. The fact that the assessee justified its method of accounting, by taking recourse to the Guidance Note issued by the ICAI in that behalf, was disregarded, on what we would term as, a disjointed reading of the provisions of the said Guidance Note. Both the assessing officer as well as the CIT(A) have adverted to paragraph 2 of the Guidance Note to come to, what we consider an erroneous conclusion in as much as they have held that in determining as to whether deduction on account of lease equalization charges ought to be allowed or not, what has to be borne in mind is ultimately the provisions of the IT Act. In our view, such an observation in paragraph 2 of the Guidance Note is really saying the obvious. Therefore, even if this Guidance Note was silent on this aspect the provisions of the I.T. Act would undoubtedly still apply. Thus, as to what is the impact of provision of para 2 of the Guidance Note will be considered by us as we progress further with our judgment.”

9. In the present case also, we notice that the Assessing Officer has not based the addition on the finding that there was incorrectness or incompleteness in the account or the accounting standard employed by the assessee were contrary to the accounting standard notified by the Government under Section 145(2) of the Act.

10. In Virtual Soft Systems Ltd. (surpa), it has been further observed as under:-

“14.3 Lease rental in monetary terms is a sum total of: the financing charge and the amount embedded in it in the form of the capital sum. What the assessee needs to do, while offering for tax income derived from lease is, to separate the financing charge from the amount recovered towards capital, that is, the capital recovery amount. The financing charge is determined by applying the IRR to the net investment made in the asset. The assessee also needs to provide for depreciation, on the capital value embedded in the lease rental. The fourth element which is the lease equalization charge is the result of the adjustment, which the assessee has to make whenever,



the amount put aside towards capital recovery is not equivalent to the depreciation claimed by the assessee. The assessee, may claim depreciation based on the provisions of the IT Act or, may even adopt the method of depreciation provided under the Companies Act. In the event, the depreciation claimed is less than the capital recovery, the difference is debited in the profit and loss account in the form of lease equalization charge, and similarly if, for any reason the depreciation claimed is more than capital recovery then, the difference is credited, once again, in the form of lease equalization charge to the profit and loss account. Therefore, the assessee in effect debits or credits its profit and loss account with a lease equalization charge depending on whether or not the depreciation claimed is, less or more than the capital recovery. The capital recovery can be known, as is evident, on deduction of financing charges from the lease rentals. In sum and substance, lease equalization charges is a method of re-calibrating the depreciation claimed by the assessee in a given accounting period. The method employed by the assessee, therefore, over the full term of the lease period would result in the lease equalization amount being reduced to a naught, as the debit and credits in the profit and loss account would square off with each other. Hence, the contention of the revenue that it is a claim in the form of a deduction which cannot be allowed, as there is no provision under the I.T. Act is, in our view, a complete misappreciation of what constitutes a lease equalization charge. In our opinion, as long as the method employed for accounting of income meets with the rudimentary principles of accountancy, one of which, includes offering only revenue income for tax, we cannot find fault with the assessee debiting lease equalization charges in the AYs in issue, in its profit and loss account. This represents true and fair view of the accounts; a statutory requirement under Section 211(2) of the Companies Act. As explained by us above, the rationale is that over the entirety of the lease period the said debit would work itself out."

11. The reasoning in the aforesaid paragraph can be best understood, if we refer to the following table by way of an example.

INDIAN RAILWAY FINANCE CORPORATION LTD. – SAMPLE FINANCE LEASE CHART

Lease Value of Rs. 1,00,000 IRR = 12.6159%					Lease Rent: Primary = 15% for 15 years Secondary = 1% for 15 years Statutory Depreciation = Rs.4750/- p.a.				
Year	Lease	Capital	Finance	Recovery	Statutory	Lease	Net Profit	Dep. As	Taxable



	Rent Recd.	Cost Outstanding	Charge at IRR	of cost of capital	Depre ciation	Equali- sation Dr./(Cr.)		per I.T.	Income
1	15000	100,000	12,616	2,384	4,750	(2,366)	12,616	25,000	(7,634)
2	15000	97,616	12,315	2,685	4,750	(2,065)	12,315	18,750	(1,685)
3	15000	94,931	11,976	3,024	4,750	(1,726)	11,976	14,063	2,664
4	15000	91,907	11,595	3,405	4,750	(1,345)	11,595	10,547	5,798
5	15000	88,052	11,165	3,835	4,750	(915)	11,165	7,910	8,005
6	15000	84,668	10,682	4,318	4,750	(432)	10,682	5,933	9,499
7	15000	80,349	10,137	4,863	4,750	113	10,137	4,449	10,437
8	15000	75,486	9,523	5,477	4,750	727	9,523	3,337	10,936
9	15000	70,009	8,832	6,168	4,750	1,418	8,832	2,503	11,079
10	15000	63,842	8,054	6,946	4,750	2,196	8,054	1,877	10,927
11	15000	56,896	7,178	7,822	4,750	3,072	7,178	1,408	10,520
12	15000	49,074	6,191	8,809	4,750	4,59	6,191	1,056	9,885
13	15000	40,265	5,080	9,920	4,750	5,170	5,080	792	9,038
14	15000	30,345	3,828	11,172	4,750	6,422	3,828	594	7,984
15	15000	19,173	2,149	12,581	4,750	7,831	2,419	445	6,723
16	1000	6,592	832	168	4,750	(4,582)	832	334	5,248
17	1000	6,423	810	190	4,750	(4,560)	810	251	5,310
18	1000	6,234	786	214	4,750	(4,536)	786	188	5,349
19	1000	6,020	760	240	4,750	(4,510)	760	141	5,369
20	1000	5,780	729	271	4,750	(4,479)	729	106	5,373
21	1000	5,509	695	305	4,750	(4,445)	695	79	5,366
22	1000	5,204	657	343	250	93	657	59	847
23	1000	4,861	613	387		387	613	45	569
24	1000	4,474	564	436		436	564	33	531
25	1000	4,038	509	491		491	509	25	484
26	1000	3,548	448	552		552	448	19	429
27	1000	2,995	378	622		622	378	14	364
28	1000	2,373	299	701		702	299	11	289
29	1000	1,672	211	789		789	211	8	203
30	1000	883	117	883		883	117	24	93
	240000		1,40,000	1,00,000	1,00,000	(0)	1,40,000	1,00,000	1,40,000

12. The net effect of the aforesaid table shows that the purchase value of the asset which is made subject matter of lease is not taken to the profit and loss account and treated or debited as expenditure. The purchase value or the recovery of capital cost gets distributed/divided over the term of the lease. The acronym IRR stands for Internal Rate of Return, on which there is no dispute. The lease rentals as stated above include recovery of the capital cost. The chart indicates depreciation which an assessee was entitled to claim under the Companies Act. Lease equalization charge represents the difference between the recovery of cost of capital and the depreciation as claimed



under the Companies Act. The difference between the two may be negative or positive and is not constant over the period of the lease. Thus, the net revenue or tax effect is NIL in the entire term. This is clear from the net profit as declared under Column 'G'. The computation is logical, fair and true reflection of the income earned and reduces abnormalities. The above table indicates that lease equalisation charge results in debit or credit entry in the profit and loss account and it helps the income getting staggered or matched during the entire period of lease.

13. It may be appropriate to also refer to the Reserve Bank of India's Prudential Norms on Income Recognition, Asset Classification and Provisioning-Pertaining to Advances dated 1st September, 2001 to Commercial Banks. Under the head Income Recognition in paragraph 3.2.3 it has been observed:-

"3.2.3 Leased Assets

- i) The net lease rentals (finance charge) on the leased asset accrued and credited to income account before the asset became non-performing, and remaining unrealised, should be reversed or provided for in the current accounting period.
- ii) The term 'net lease rentals' would mean the amount of finance charge taken to the credit of Profit & Loss Account and would be worked out as gross lease rentals adjusted by amount of statutory depreciation and lease equalisation account.
- iii) As per the 'Guidance Note on Accounting for Leases' issued by the Council of the Institute of Chartered Accountants of India (ICAI), a separate Lease Equalisation Account should be opened by the



banks with a corresponding debit or credit to Lease Adjustment Account, as the case may be. Further, Lease Equalisation Account should be transferred every year to the Profit & Loss Account and disclosed separately as a deduction from/addition to gross value of lease rentals shown under the head 'Gross Income.'

14. A perusal of the balance sheet and profit and loss account for the assessment year 2000-01 reflects the said position. In the said year, the assessee had received lease rentals of Rs. 2700.48 crores, from which lease equalization account of Rs.142.03 crores was reduced. The paid up capital of the respondent company held by the President of India and his nominees was Rs.232 crores. The addition of the fixed assets in the said year was Rs. 2273 crores which is reflective as the addition to the quantum of rolling stock. If the purchase price of the rolling stock stands subjected to revenue deduction, would have its own consequences and lead to abnormal financial results and absurdities. The balance sheet records that the total rolling stock aggregate was Rs. 19771.35 crores. The depreciation claimed (which may include certain fixed assets also which were not subject matter of finance leases) was Rs.5352.57 crores. Clearly, therefore, the purchase value of the leased assets did not find reflection or deduction in the profit and loss account. Legal ratio of Virtual Soft Systems Ltd. (supra) is that as long as the assessee does not indulge in any manipulation of the figures and the capital cost, IRR etc. are computed in accordance with the accountancy standards and no error can be found,



lease equalisation charge should not be disallowed.

15. In view of the aforesaid position, the second issue has to be decided against the appellant and in favour of the respondent-assessee.

Issue No.3

Whether the bond issue expenses were capital or revenue in nature?

16. The respondent-assessee had incurred expenditure of Rs.10,09,92,445/- towards bond issue expenses of different series during the year in question. Tribunal referred to their earlier order in the case of the respondent-assessee for the assessment years 1997-98 to 2000-01 and held that the expenses incurred were revenue expenditure. Reliance was placed upon decision of the Delhi High Court in the case of *CIT Vs. Thirani Chemicals Ltd.* [2007] 290 ITR 196 wherein it has been held that issue of debentures on rights basis to the existing shareholders was revenue expenditure and it was not mandatory to amortise the said amount under Section 35D of the Act in view of the Circular No.52 dated 19th March, 1971 issued by the Central Board of Direct Taxes.

17. While dealing with a similar issue in *Commissioner of Income Tax Vs. Havells India Ltd.* (2012) 208 TAXMAN 114 it has been held as under:-

“26. It is well settled that expenditure incurred in



connection with the issue of debentures or obtaining loan is revenue expenditure. Reference in this connection may be made to the leading judgment of the Supreme court in India Cements Ltd. v. CIT, (1966) 60 ITR 52. The question before us however, is whether it is a debenture issue or an issue of share capital ITA involving the strengthening of the capital base of the company. Though it prima facie appears that there are sufficient facts to indicate that what was contemplated was an issue of shares to the Mauritius Company under the Investor Agreement which would result in strengthening of the assessee's capital base, having regard to the judgments cited on behalf of the assessee, in which it has been held that despite indications to the effect that the debentures are to be converted in the near future into equity shares, the expenditure incurred should be allowed as revenue expenditure on the basis of the factual position obtaining at the time of the debenture issue, we are not inclined to take a different view. The following cases have been cited on behalf of the assessee in support of the view that even in such a situation the expenditure is allowable as revenue expenditure:-

- (i) CIT v. East India Hotels Ltd., (2001) 252 ITR 860 (Cal.)
- (ii) CIT v. ITC Hotels Ltd., (2011) 334 ITR 109 (Kar.)
- (iii) CIT v. South India Corporation (Agencies) Ltd., (2007) 290 ITR 217 (Mad.)
- (iv) CIT v. First Leasing Co. of India Ltd., (2008) 304 ITR 67 (Mad.)

27. In addition to the above judgments, we also have the judgment of the Rajasthan High Court (supra) against which the Special Leave Petition filed by the Revenue was dismissed. Having regard to the predominant view taken in the above judgments, in which the judgment of the Supreme Court in India Cement (supra) has been noticed, we are inclined to uphold the view taken by the Tribunal that the expenditure is revenue in nature."

18. The respondent-assessee was/is a Government of India undertaking and was engaged in the business of leasing and financing to Indian Railways. It procured funds from various sources and acquired rolling stock which was leased to Indian Railways. The expenditure which was incurred on bonds was for ensuring finance and



availability of funds for carrying out the business of finance a leasing. To procure and get funds in the form of bonds etc. some expenditure had to be incurred. These funds, when procured, were used for the business activities to earn income. It is not a case wherein the respondent-assessee was yet to setup or commence their business. The business, it is accepted, had commenced much earlier and not during the year in question.

Issue No.4

Whether the assessee is entitled to depreciation on office premises at NBCC place, Lodi Road, New Delhi?

19. The contention of the Revenue raised is that the respondent-assessee was not the owner of the building or in possession in part performance under Section 53A of the Transfer of Property Act. Learned senior standing counsel has referred to the observations and the contentions raised by the Revenue in paragraphs 17 and 18 of the impugned order, wherein reference is made to agreements dated 11th April, 2002 and 21st November, 2002. In the agreement dated 21st November, 2002, it stated that NBCC had handed over vacant possession to the respondent-assessee. The respondent-assessee, on the other hand, had relied upon letter dated 29th March, 2000 received from NBCC wherein it was clearly mentioned that commercial space measuring 625 square meters was allotted to the respondent-assessee



vide letter^d dated 28th April, 1998 and commercial space measuring 2 square meters was initially purchased by MMTC but was sold by them to the respondent-assessee. After noticing the conflicting positions, the tribunal in paragraph 20.1 has referred to their decision dated 28th August, 2009 for assessment year 2002-03. They have quoted the possession letter dated 29th March, 2000 and reached a conclusion that possession was “in fact” or actually was handed over to the assessee before the end of financial year ending 31st March, 2000. The respondent-assessee, therefore, became entitled to benefit under Section 53A of Transfer of Property Act and accordingly decision of the Supreme Court in *Mysore Minerals Vs. CIT* [2009] 239 ITR 775 (SC) was applicable.

20. The aforesaid findings are findings of fact. The tribunal has taken into account and relied upon the possession letter dated 28th April, 1998 in which NBCC had accepted that the possession of the space measuring 625 square meters and 285 square meters was handed over to the respondent assessee on 23rd September, 2000. NBCC was/is a Government of India undertaking and it is difficult to accept the contention of the Revenue that they would have fudged or manipulated the date of possession. The factual finding is not perverse.



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21. In view of the aforesaid position, we do not find any merit in present appeal and the same is dismissed.

A handwritten signature in black ink, appearing to read 'S. Khanna'.

(SANJIV KHANNA)

Judge

A handwritten signature in black ink, appearing to read 'Sanjeev Sachdeva'.

(SANJEEV SACHDEVA)

Judge

OCTOBER 31, 2013

NA/KKB